

Message Text

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PAGE 01 MANAMA 01350 01 OF 02 251855Z

ACTION NEA-10

INFO OCT-01 ISO-00 SP-02 USIA-15 AID-05 EB-07 NSC-05
EPG-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00
COME-00 FRB-01 INR-07 NSAE-00 XMB-04 OPIC-06
LAB-04 SIL-01 L-03 H-02 PA-02 PRS-01 IGA-02 /101 W
-----088761 251901Z /41

R 251620Z JUN 77

FM AMEMBASSY MANAMA BAHRAIN

TO SECSTATE WASH DC 4825

INFO AMEMBASSY ABU DHABI UAE

AMCONGEN DHAHRAN SAUDI ARABIA

AMEMBASSY DOHA QATAR

AMEMBASSY JIDDA SAUDI ARABIA

AMEMBASSY KUWAIT KUWAIT

AMEMBASSY MUSCAT OMAN

UNCLAS SECTION 1 OF 2 MANAMA 1350/1

E.O. 11652: N/A

TAGS : EALR, EFIN, BA

SUBJECT : BAHRAIN ANNOUNCES DECISION TO ISSUE DEVELOPMENT
BONDS AMIDST CONCERN ABOUT EXCESS LIQUIDITY,
RECESSION AND CRASH IN LAND VALUES

1. THE GOB HAS ANNOUNCED ITS INTENTION TO ISSUE UP TO \$75
MILLION (BD 30 MILLION) IN DEVELOPMENT BONDS OVER THE NEXT
TWO YEARS. THE FIRST ISSUE WILL BE OFFERED IN OCTOBER,
PROBABLY OF ONE THIRD OF TOTAL, INTEREST WILL BE APPROXIMATELY
7.5 PERCENT (DEPENDING ON MARKET CONDITIONS AT THE TIME). ONLY
BAHRAINI INSTITUTIONS (COMMERCIAL BANKS, INSURANCE COMPANIES
AND LOCAL FIRMS) WILL BE ELIGIBLE FOR PURCHASE. IT IS
ASSUMED THAT THE NEW SOCIAL INSURANCE ORGANIZATION AS
WELL AS THE EMPLOYEE RETIREMENT FUNDS OF BAPCO AND ALBA
WILL PURCHASE BONDS. IT WILL BE THE FIRST ISSUE OF SUCH
BONDS BY A GULF REGION GOVERNMENT (ALTHOUGH THE INDUSTRIAL
BANK OF KUWAIT ISSUED LOCAL BONDS LAST YEAR).

UNCLASSIFIED

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PAGE 02 MANAMA 01350 01 OF 02 251855Z

2. ACCORDING TO THE MINISTER OF FINANCE, IBRAHIM ABDULKARIM,
AND THE DIRECTOR GENERAL OF THE BAHRAIN MONETARY AGENCY,
ALAN MOORE, THE AIM OF THE ISSUANCE IS TWOFOLD: (A) TO ABSORB
EXCESS LIQUIDITY IN THE LOCAL MARKET WHICH IS CONSIDERED TO
CONTRIBUTE TO INFLATION; AND (B) TO PROVIDE A FRESH SOURCE
OF SIGNIFICANT INCOME TO THE GOB. THE MOVE, RECOMMENDED IN
LATE 1975 BY A SPECIAL IMF TEAM WHICH VISITED BAHRAIN AT THE

INVITATION OF THE GOB TO ADVISE ON WAYS TO GENERATE INCREASED GOVERNMENT REVENUES, IS BEING MADE AT A TIME WHEN OFFICIALS, MERCHANTS, AND THE BANKING COMMUNITY ARE INCREASINGLY CONCERNED ABOUT EXCESS LIQUIDITY WHICH HAS LED TO EXCESSIVE LAND SPECULATION AND RAMPANT INFLATION IN BAHRAIN. OFFICIALS BELIEVE THAT BONDS WILL PROVIDE AN ALTERNATE AND ATTRACTIVE SOURCE OF INVESTMENT AND THEREBY HELP CHANNEL LOCAL CURRENCY OUT OF VICIOUS CIRCLE IN WHICH EXCESS FUNDS HAVE CHASED LIMITED GOODS, PARTICULARLY LAND, AND SERVICES WITH RESULTANT INFLATION.

3. AS IN U.A.E. (SEE ABU DHABI 1665), LOCAL OFFICIALS FEEL THAT IN THE 1973-1976 BOOM PERIOD, LOCAL BANKS GOT OVEREXTENDED IN GRANTING LOANS TO FINANCE CONSTRUCTION PROJECTS. SUCH LENDING, FOR EXAMPLE, INCREASED BY 66 PERCENT IN 1976 OVER 1975, AS DID THE MONEY IN CIRCULATION. IN 1977, THE FIRST QUARTER INCREASE IN SUCH CONSTRUCTION LOANS WAS ONLY 13 PERCENT ABOVE THE SAME QUARTER IN 1976. WITH THE SURPRISE COLLAPSE OF THE VIKING CONSTRUCTION CO. IN THE EARLY FALL OF 1976 AND THE RESULTANT LOSS OF \$7.5 MILLION (BD. 3 MILLION) BY THE NATIONAL BANK OF BAHRAIN, THE GOB AND THE LOCAL BANKING COMMUNITY WERE JARRED INTO THE REALIZATION THAT CONSTRUCTION LOANS HAD GOTTEN OUT OF HAND. LOCAL BANKERS NOW ARE QUICK TO ADMIT THAT THEY MADE LOANS ON THE BASIS OF THE PRESTIGE AND STATUS OF THOSE INVOLVED (PRACTICALLY EVERYONE OF SIGNIFICANCE ON THE UNCLASSIFIED

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PAGE 03 MANAMA 01350 01 OF 02 251855Z

ISLAND) AND NOT ON THE MERITS OF THE PROJECT. NOW, THE BAHRAIN MONETARY AGENCY HAS ISSUED GUIDELINES FOR ASSESSING LOAN APPLICATIONS AND HAS PLACED AN OVERALL CEILING ON LOANS FOR CONSTRUCTION. AN ADDITION PROBLEM WAS THAT LOANS WHICH SUPPOSEDLY WERE FOR CONSTRUCTION, OFTEN IN FACT WERE APPLIED TO LAND SPECULATION.

4. WITH THE CONSTRUCTION BOOM FINALLY HAVING CREATED ENOUGH OFFICE SPACE AND MORE THAN ENOUGH RESIDENTIAL VILLAS FOR THE WEALTHY, THERE IS A DEFINITE DEPRESSION IN PRICES FOR BOTH. THIS HAS CAUGHT SOME MERCHANTS AND CIVIL SERVANTS IN AN OVEREXTENDED POSITION AND THEY ARE UNABLE TO PAY BACK LOANS TO BANKS. THE DIRECTOR GENERAL OF THE BAHRAIN MONETARY AGENCY AND THE MANAGING DIRECTOR OF THE NATIONAL BANK OF BAHRAIN CONFIRM THAT THERE WILL BE A FEW BANKRUPTCIES OVER THE NEXT SIX MONTHS AND LOCAL BANKS WILL HAVE TO WRITEOFF SOME OF THE LOANS; IN GENERAL, HOWEVER, THEY PROBABLY WILL NOT PRESS FOR REPAYMENT AND, OVER THE NEXT FEW YEARS, THE MERCHANTS AT LEAST WILL PROBABLY BE ABLE TO PAY OFF THEIR LOANS.

5. ALL OFFICIALS INSIST THAT TALK OF A 'RECESSION' IS

GROSSLY EXAGGERATED. WHAT IS HAPPENING THEY SAY IS THAT THE RAPID BOOM PHASE WHICH BAHRAIN AND OTHER STATES IN THE REGION HAVE WITNESSED SINCE 1973 IS TAPERING OFF AND A PERIOD OF STABILIZATION HAS BEEN ENTERED. THIS PERIOD STILL BOASTS GROWTH RATES (IN IMPORTS, BANK LOANS, MONEY IN CIRCULATION, ETC.) OF APPROXIMATELY TWENTY PERCENT ANNUALLY. IN MOST PARTS OF THE WORLD THIS WOULD BE CONSIDERED FANTASTIC GROWTH; IN THE GULF, HOWEVER, THESE RATES ARE DOWN FROM THE 50-75 PERCENT ANNUAL INCREASES OF THE PAST FEW YEARS AND THUS APPEAR TO SOME AS RECESSION OR EVEN COLLAPSE.

6. THE MINISTER OF FINANCE EMPHASIZED TO US ON JUNE 22 THAT WHAT IS HAPPENING IN BAHRAIN IS A REFLECTION OF A UNCLASSIFIED

UNCLASSIFIED

PAGE 04 MANAMA 01350 01 OF 02 251855Z

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PAGE 01 MANAMA 01350 02 OF 02 251928Z
ACTION NEA-10

INFO OCT-01 ISO-00 SP-02 USIA-15 AID-05 EB-07 NSC-05
EPG-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00
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UNCLAS SECTION 2 OF 2 MANAMA 1350/2

REGIONAL TREND, JUST AS ITS BOOM WAS. HE EXPECTS THAT HE REGION AS A WHOLE IS SETTling DOWN TO A PERIOD OF CONSOLIDATION AND STABILIZATION MARKED BY STEADY AND

HEALTHY RATES OF INCREASE. SOME COMPANIES AND INDIVIDUALS
WILL SUFFER -- A FEW WILL COLLAPSE. THE GOLD RUSH,
BOOM-TOWN ATMOSPHERE OF THE PAST THREE YEARS HAS, HE
ASSERTED, ENDED.

7. COMMENT: SEVERAL SENIOR GOB OFFICIALS AND SOME
MERCHANTS HAVE FELT FOR THE PAST 9-12 MONTHS THAT THE BAHRAIN
ECONOMY HAD GOTTEN 'OVERHEATED' AND, IN A SENSE, WAS OUT
OF RATIONAL CONTROL. INFLATION WAS AND IS A PROBLEM OF
GREAT CONCERN TO THE GOB, PARTICULARLY BECAUSE OF ITS
AFFECTS ON THE LIFESTYLES OF LOWER-MIDDLE AND WORKING
CLASS BAHRAINI WHO, DESPITE SIZEABLE WAGE INCREASES IN
THE PAST TWO YEARS, HAVE PROBABLY BEEN EXPERIENCING AN
ABSOLUTE DECLINE IN STANDARD OF LIVING.

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PAGE 02 MANAMA 01350 02 OF 02 251928Z

8. THE GOB INTENDS TO SELL THE SECOND AND THIRD BOND TRANCHES
TO INDIVIDUALS AS WELL AS INSTITUTIONS, ONCE THE REVOLUTIONARY
(FOR THE GULF) IDEA OF GOVERNMENT BONDS IS MORE GENERALLY
UNDERSTOOD AND ACCEPTED BY THE PUBLIC. WE UNDERSTAND THAT
EVEN IN THE CABINET THERE WAS SIGNIFICANT RESISTANCE TO THE
CONCEPT OF THE GOVT BORROWING FROM THE PUBLIC ON THE GROUNDS
THAT THE BONDS, THOUGH OF COURSE VOLUNTARY, WOULD APPEAR
TO BE A TAX.
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